APPENDIX.

Memorandum Decision and Order Granting Defendant Summary Judgment and Dismissing Plaintiffs Complaint (Jan. 14, 1966).

(SAME TITLE)

BRENNAN, Judge.

This litigation, brought by two Trustees in Bankruptcy, arises from the complicated and alleged interwoven financial affairs of the three bankrupts named in the above caption.

The defendant, hereinafter referred to as "First Federal", has moved before this court seeking several types of relief, all of which have become academic except the motion to dismiss the complaint because same fails to state a claim against the defendant upon which relief can be granted. Upon the return day of the motion, voluminous supporting affidavits, documents etc. were filed in behalf of the moving party in support of the motion. It developed therefrom that a similar action had been brought by the same plaintiffs against the defendant in the State Supreme Court of Onondaga County. At the time of the return day of the motion, it appeared that there was pending, undetermined in the state court, defendant's motion for a summary judgment dismissing the complaint therein. Under the circumstances and upon the understanding that the actions were similar, this court stayed proceedings in this action awaiting the outcome of the pending motion in the state court. This court is now furnished with a copy of the decision of Supreme Court Justice Ringrose which granted the defendant's motion for a summary judgment dismissing the complaint and denied some six applications for relief, only one of which is pertinent here and which will be referred to below. Copy of an order in accordance with the decision is also submitted

to this court which is dated July 9, 1964 and filed in the Clerk's office of Onondaga County on July 14, 1964. The plaintiffs filed a notice of appeal to the Appellate Division Fourth Department and on motion of the defendant, same was dismissed by order dated November 30, 1965, copy of which has also been furnished this court.

An understanding of this decision requires a brief statement as to the background of and nature of the litigation instituted in both courts. The two corporations and the individual named in the caption, were adjudicated bankrupts on February 11, 1963 and May 28, 1963. The plaintiffs were duly appointed trustees of their estates by the Bankruptcy Court. Thereafter and about November 1963 an action was brought by the present plaintiffs against the defendant in the Supreme Court of Onondaga County. In that action, the plaintiffs sought to recover a money judgment in the amount of $248,000. with interest, based upon the contention that a business transaction which ultimately resulted in a mortgage loan by the defendant to the Randolph House Motor Hotel Corporation was in fact in violation of New York statutes. The asserted right to recover was based upon the contention that the payment to the defendant of $124,000. as an "origination" fee was in violation thereof. The background of the contention appears to be in substance that the Potter Securities Corporation and the Randolph Corporation were "dummy" corporations actually used to facilitate the borrowing of monies by the individuals involved and to conceal the alleged illegal mortgage loan. The preliminary negotiations and the documents involved therein which led to the mortgage loan, referred to above and dated June 26, 1962, are somewhat complicated and the details of same would seem to be unnecessary to this

decision. It is sufficient to say that the defendant contended that the documents involved showed without contradiction that its dealings were entirely with either of the two bankrupt corporations and that the ultimate transaction was in effect the recast or consolidation of corporate indebtedness owed by said corporations to a Syracuse bank. In any event, plaintiffs appear in no way to dispute but that the state court decision is a bar to the present action in this court insofar as the right to recover upon the contention that the "origination" fee was tainted by the state usury statute.

The controversy here arises only by plaintiffs' assertion submitted to this court in letter form that the present complaint should not be dismissed in its entirety for the reason that same presents a claim for relief in addition to that embraced on the so-called origination fee. This item is in the total amount of $55,144. It consists of three items alleged to represent payments by Donald S. Potter upon the mortgage held by the defendant, said payments being made in the months of August and September 1962.

If, as the state court has held, the usury statutes do not apply, it is difficult to understand how the payments alleged to have been made upon the valid mortgage instrument held by the defendant would be invalidated. The alleged fact that the payments were made by Donald Potter might have some relevancy to plaintiff's principal contention that the corporations were mere dummies through which he acted but would seem to have no probative effect upon the validity of the instrument itself. The above is not the full measure of plaintiff's difficulty in regard to this contention.

A motion was made before Justice Ringrose in the state court in which the plaintiffs requested permission to file a

supplemental complaint in which the plaintiffs sought to set up as a separate cause of action the identical three items of payments made as above. In fact the allegations in the supplemental complaint relative to such payments are substantially identical with those found in the present complaint. Justice Ringrose, on page 11 of his decision, specifically denied the requested permission and such denial was repeated in his order of July 9, 1964.

A comparison of the complaint and proposed supplemental complaint in the state court action with the present complaint in this court shows that the allegations of same are substantially similar and in most allegations the language used is identical. The right to recover, asserted by the plaintiffs in the state court action, rests upon the same factual and legal bases.

The problem is then further reduced to determining whether or not the principle of res judicata is applicable to the present motion which, since matters outside of the pleading, have been presented and not excluded by the court, may be considered as a motion for summary judgment. Rule 12 F. R. C. P.

No question is raised but that the state court had jurisdiction in the matter of the cause of action above referred to, as instituted and decided therein. Reported legal precedents appear to be unanimous in holding that an adjudication of a controverted matter by a competent state court forecloses further litigation as to issues actually raised and as to relevant issues which could have been litigated therein. This court does not understand that the above principle is seriously disputed. Same is discussed in the well known case of Angel v. Bullington, 330 U. S. 183. The following quotation, taken from Heiser v. Woodruff, 327 U. S. 726 at 733, 734, seems to be particularly appropriate. "It is well

settled that where the trustee in bankruptcy unsuccessfully litigates an issue outside the bankruptcy court". This latter decision is cited in our own circuit in the case of Masterson v. Atherton, 328 F. 2d 106 and the quotation, appearing at page 108, taken from Heiser v. Woodruff, supra, is likewise pertinent to the present motion, See also Walters v. Wilson, 142 F. 2d 59; Hobbs v. Franklin Jewelry Co. Inc., 131 F. 2d. 432; in re Epstein, 48 F. S. 436.

The above authorities applied to the facts and circumstances in this case are sufficient to conclude that the principle of res judicata applies and that defendant's motion, treated as one for a summary judgment, dismissing the complaint, must be and is granted, and it is

SO ORDERED.

STEPHEN W. BRENNAN
Senior U. S. District Judge.

RINGROSE, J.:

The plaintiffs herein moved for summary judgment or partial summary judgment which motion was withdrawn pending examinations before trial.

The defendant and third-party plaintiff cross moves pursuant to Rule 3212 C.P.L.R. for summary judgment dismissing the complaint.

On April 27, 1962, the defendant entered into a mortgage commitment agreement with Potter Securities Corporation to loan the latter $3,100,000.00 secured by a mortgage on the property of Randolph House Motor Hotel Corp., the capital stock of which was entirely owned by Potter Securities Corporation.

The mortgage commitment agreement provided that Potter Securities Corporation was to pay a mortgage origination fee in the total amount of $124,000.00 payable in two installments of $62,000.00 each.

The plaintiffs seek in this action to recover from the defendant the sum of $248,000.00 with interest on $62,-

000.00 from April 27, 1962, and with interest on $62,000.00 from June 21, 1962.

It is the contention of the plaintiffs that the above transaction was in violation of the usury statutes. (General Business Law, Article 25 and Article 10 of the Debtor and Creditor Law.) In support of this contention and to evade the impact of applicable statutes and case law to the contrary in respect to corporate transactions, the plaintiffs allege in substance that the Potter Securities Corporation was organized for the purpose of concealing the financial transactions of Donald S. Potter, individually, and that the corporate entity, in equity and good conscience, should be disregarded.

Potter Securities Corporation was originally incorporated under the name of Potter Hotel Corporation according to the Certificate of Incorporation filed with the Secretary of State on September 19th, 1946. (Exh. "G" appended to defendant's moving papers.) Thereafter, and on November 24, 1947 by certificate duly executed by Jackson M. Potter, and filed in the office of the Secretary of State of New York on December 19, 1947, the name was changed to Potter Securities Corporation. On the occasion of filing the certificate of the change of name, Shirley Feldman certified that she was secretary of Potter Hotel Corporation and that Jackson M. Potter, in person or by proxy, was the holder of all of the outstanding shares of the corporation entitled to vote on the change of name. (Last two pages Ex. "G" of defendant's moving affidavit.)

The Certificate of Incorporation of Randolph House Motor Hotel Corporation was filed with the Secretary of State on December 27, 1960, and in the Onondaga County Clerk's Office on January 12, 1961, approximately fourteen years after the Potter Hotel Corporation was incorpor-

ated. The total number of shares of capital stock authorized was two hundred, all of which were to be issued without par value. (Exhibit "H", defendant's motion papers.)

Payment to the defendant of the mortgage indebtedness was guaranteed by an agreement in writing executed on June 22, 1962, by Donald S. Potter and Jackson Potter.

On February 11, 1963, Randolph House Motor Hotel Corp., was adjudicated a bankrupt and Eugene H. Klein, a plaintiff herein, was appointed trustee in bankruptcy.

Thereafter and on May 28, 1963, Donald S. Potter was adjudicated a bankrupt and on May 28, 1963, both Potter Securities Corporation and Jackson M. Potter were adjudicated bankrupt.

On June 25, 1963, Philip J. McNellis was appointed Trustee in Bankruptcy of Donald S. Potter and Potter Securities Corporation.

It is alleged in the complaint that according to the schedules in bankruptcy filed by Donald S. Potter, the claims of unsecured creditors totaled $1,301,362.62 and that the time to file claims has not expired.

The plaintiff contends (Par. 19 of the complaint) that "At all times hereinafter mentioned, Potter Securities Corporation was a 'dummy' corporation having no assets; doing no business; keeping no books; and merely from time to time, held record title of certain properties for and on behalf of and as a convenience to Donald G. Potter, the true and accountable owner of such properties, for the purpose of concealing usurious transactions, particularly in respect to the transaction with the defendant and Potter Securities Corporation".

It is alleged in the complaint of the plaintiff that all of the stock issued by Randolph House Motor Corp., (hereafter, Randolph) was at all times owned by Donald S. Potter and that no capital was paid to Randolph by Donald S. Potter for the issuance of said stock.

It is alleged in the following paragraphs of the verified complaint of the plaintiffs that:

> "20. On the 27th day of January 1959, Donald S. Potter purchased premises briefly known as part of farm lots 99 and 105 in the Town of Salina." (Site of Randolph Motor Hotel.)
>
> "21. Without consideration on March 20, 1959, Donald S. Potter executed and delivered to Potter Securities Corporation a Deed to said premises dated, acknowledged and recorded on March 20, 1959."
>
> "22. Without consideration, on June 4, 1959, Potter Securities Corporation executed and delivered a Deed to Donald S. Potter to said premises dated, acknowledged and recorded on June 4, 1959."
>
> "23. Without consideration, on February 24, 1961, Donald S. Potter executed and delivered a Deed to said premises dated, acknowledged and recorded February 24, 1961, to Potter Securities Corporation."
>
> "24. Without consideration Potter Securities Corporation executed and delivered a Deed to premises to Donald S. Potter dated, acknowledged and recorded February 28, 1961."
>
> "25. Without consideration Donald S. Potter executed and delivered a Deed to Potter Securities Corporation to said premises dated, acknowledged and recorded on the 17th day of April, 1961."

"26. Without consideration. Potter Securities Corporation executed and delivered a Deed to said premises to Randolph House Motor Hotel Corp. dated, acknowledged and recorded June 21, 1962."

During the period within which the above mentioned frequent transfers occurred, the Randolph House Motor Hotel was completed and furnished.

If the allegations of the complaint and averments in the affidavits of the plaintiffs are correctly interpreted, the plaintiffs seek to establish, by the above mentioned transfers, that the subject mortgage loan to Randolph was in truth and in fact knowingly made by the defendant for the benefit of Donald S. Potter, an undisclosed principal and thus avoid the immunity of the usury statutes to transactions between corporations.

The applicable statute and case law was recently exhaustively examined and correlated by Mr. Justice Simons in a motion for summary judgment in an action by Philip J. McNellis as Trustee of Donald S. Potter and Jackson M. Potter, Bankrupts v Columbia University. That action, as is this, was based upon the usury statute and also involved the financing of the construction of "Randolph" and consequently the issue of usury will not be considered at length herein. (Philip J. McNellis, as Trustee of Donald S. Potter and Jackson M. Potter, Bankrupts v Columbia University, —— Misc. ——, not yet reported.)

The defendant, First Federal Savings and Loan Association, challenged the sufficiency of the complaint on the ground that in paragraph 29 of the complaint which is incorporated in paragraph 30 of the complaint for a second cause of action and paragraphs 1, 2, 3, 4, 12 and 14 of the

notice of motion by the plaintiffs to strike and for summary judgment base their demand for relief upon the payment of the mortgage origination charge by Donald S. Potter. This, in itself, would require a dismissal of the plaintiffs' motion for summary judgment, since usury is only available to a borrower as a defense. (Salvin v Myles Realty Co., 227 N.Y. 51, p. 57; Edelman v Cymberg, 261 A.D. 698, 699; Kahn v Sohmer, 12 A.D. 2d 982; Del Rubio v Duchesne, 284 App. Div. 89, 94.)

This rule is succinctly stated in Jenkins v Moyse (254 N.Y. 319). Said the Court: "* * To sustain the judgment there must be evidence * * * that the defendants agreed to loan money to plaintiff, and did in fact make the loan to him. * * * there must be proof, at least, that there was an individual transaction which the parties might desire to conceal".

Here the loan was made to Randolph and not to an individual. Furthermore, it appears from the Loan Settlement Statement (Exh. 6 of plaintiffs' bill of particulars) and paragraph 11 (b) of plaintiffs' bill of particulars that the payment of the mortgage origination fee was made by Randolph. There is no allegation in the pleadings that Potter Securities Corporation made any payment. Moreover, the modification and extension agreement dated June 22, 1962, was between defendant and Randolph (Exh A of defendant's moving affidavit and Exh. 6 p. 2 of plaintiffs' bill of particulars) and which is admitted in paragraph 11 (b) of plaintiffs' bill of particulars. The accuracy of the foregoing contention of the defendant is corroborated by the affidavits of Eugene Bersani, William E. Scheu and Herbert A. Rogers, including the correspondence with the latter. (Exhs. B, C, D & E of defendant's affidavit and Exh. 6 of plaintiffs' bill of particulars.) The documentary proof

establishes beyond per adventure that no payments were made at any time by Donald S. Potter to the defendant. The proceeds of the mortgage loan in the amount of $3,100,000.00 was used primarily in refinancing outstanding secured loans as indicated on Exh. 6 of plaintiffs' bill of particulars and resulted in the reduction of the interest rate to six per cent (6%) and a 20-year extension of the mortgage indebtedness.

Lastly, it is established by documentary proof submitted on the motion that Randolph was solvent on June 21, 1962, when title of Randolph property was transferred to it according to plaintiffs' bill of particulars, paragraph 6 (a) The plaintiffs further therein admit that a contract for a sale of the property to First Republic Building Corp. was in existence, reciting a sale price of $5,250,000.00, and plaintiffs admit that the mortgages encumbering the property did not exceed $5,057,142.50.

Omitting further specification of documentary exhibits, it is conclusively established that the negotiations related to a loan from the defendant to Randolph to be secured by a first mortgage. There were no negotiations relating to a loan to an individual or individuals.

Even assuming that the funds necessary to pay the origination fee of $124,000.00 were borrowed by individuals and loaned to the corporation liable for the origination fee, the payment would not be usurious.

The authoritative law on this issue was fully correlated and ennunciated in Jenkins v Moyse (254 N.Y. 319).

Lastly, the plaintiffs urge, in substance, that the corporations were formed for the sole purpose of shielding the usurious transactions of the individuals and that in the in-

terest of justice and good conscience, the corporate entity should be disregarded to prevent fraud. (Jenkins v Moyse, 254 N.Y. 319, 324; International Aircraft Trading Co. v Manufacturers Trust Co., 297 N.Y. 285, 292.)

There are instances where corporations in the exclusive ownership and control of individuals have been used for their personal advantage, that the Courts have rejected the corporate entity to prevent fraud and imposed liability on the individual owning the outstanding shares of stock of the corporation. (Bartle v Finkelstein, 19 A.D. 2d 256.)

The authorities in which that contention has been successfully urged are rare and have been sustained only in those cases where the transactions have been between two or more corporations, the stock of which have been exclusively owned by the same individuals and the dual ownership has been used to defeat the claims of innocent third parties. (Berkey v Third Ave. Ry. Co., 244 N.Y. 84.)

The above authority is not applicable to the instant action. The logical application of the equitable doctrine of piercing the corporate veil was admirably stated by the Court in Halsted v Globe Indemnity Co., (258 N.Y. 176) wherein it was said:

> "In passing on this question no doubt can arise that the corporation must be viewed as an entity, separate and distinct from its stockholders. No rule of common sense or common justice is thereby violated. No wrong or fraud is shielded by the corporate charter. The corporation exists for the legitimate convenience of the stockholders, not a mere mask for the personal acts and responsibilities. It absorbs and takes the place of the individuals who own its stock. (Werner v Herst, 177 N.Y. 63; Brock v Poor, 216 N.Y. 387; Berkey v Third Ave. Ry. Co., 244 N.Y. 84.)"

The documentary proof submitted on this motion conclusively demonstrates that the refinancing of the outstanding mortgage indebtedness of Randolph by defendant was exclusively a transaction between business corporations and not subject to the usury statutes.

As was pointed out by Justice Simons in McNellis as Trustee, etc. vs Columbia University, which in the interest of convenience is quoted: "The New York General Business Law Section 374 provides that corporations shall not interpose the defense of usury in any action. This Section applies not only to corporations defending claims but also prevents a corporation from suing affirmatively to set aside conveyances and contracts on the grounds of usury. (Curtis v Leavitt, 15 N. Y. 9, p 152; Southern L & T Company v Packer, 17 N.Y. 51; Rosa v Butterfield, 33 N.Y. 665.) A corporation's representative stands in no better position than does the corporation itself, and is, likewise, prohibited from asserting the claim of usury in an affirmative action. (Butterworth v O'Brien, 23 N.Y. 275; Curtis v Leavitt, supra, page 132) and this is so even if the corporation was formed for the sole purpose of avoiding the usury statute. (Jenkins v Moyse, 254 N.Y. 319; Union Dime Savings Bank of New York v Wilmot, 94 N.Y. 221.)"

"Where the corporation is the principal obligor the fact of incorporation is a defense to usury and the Courts may not disregard the corporate entity. (Werger v Haines Corporation, 94 N.Y.S. 2d 691, affd. 277 A.D. 1108, 101 N.Y.S. 2d 361, affd. 302 N.Y. 930; Kings Mercantile Company, Inc. v. Cooper, 199 Misc. 381, 100 N.Y.S. 2d 754.)

It follows that the motion of the defendant for summary judgment dismissing the complaint with costs should be granted.

In view of the decision above announced, the following motions concurrently or subsequently argued or submitted by the plaintiffs in this action are denied without costs:

FIRST: Pursuant to Section 3042 C.P.L.R. to strike in part the demand of the defendant for a bill of particulars.

SECOND: Pursuant to Section 3211 C.P.L.R. to strike affirmative defenses.

THIRD: Pursuant to Section 3212 (g) C.P.L.R. to limit questions of fact.

FOURTH: To strike answering affidavits of Mitchell T. Williams in opposition to plaintiffs' motion to strike affirmative defenses.

FIFTH: To strike the affidavit of Mitchell T. Williams and Cortland L. Brovitz in support of defendant's motion pursuant to Section 3212 C.P.L.R. for summary judgment or partial summary judgment.

SIXTH: Permitting plaintiffs to file and serve a supplemental complaint.

ORDERED ACCORDINGLY.

/s/ E. H. RINGROSE
Justice Supreme Court

Dated: Rome, New York,
June 19, 1964.

At a term of the Appellate Division of the Supreme Court of the State of New York in and for the Fourth Judicial Department, at the City of Rochester, N.Y., commencing on the 30th day of November, 1965.

Present—Hon. Alger A. Williams, *Presiding Justice*. Hon. Harry D. Goldman, Hon. Frederic T. Henry, Hon. Frank Del Vecchio, Hon. John S. Marsh, *Associate Justices*.

PHILLIP J. McNELLIS AS TRUSTEE OF DONALD S. POTTER, BANKRUPT, AND POTTER SECURITIES CORPORATION, BANKRUPT, EUGENE H. KLEIN AS TRUSTEE OF RANDOLPH HOUSE MOTOR HOTEL CORP., BANKRUPT, Appellants,

vs

FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF ROCHESTER, Respondent,

vs.

MYRON S. MELVIN, et al., Third Party Defendants, etc.

A motion having been made on the part of the respondent to dismiss the appeal to this Court taken in the above entitled action, from an order of the Supreme Court, entered in the office of the Clerk of the County of Onondaga on the 14th day of July, 1964, for the failure of the appellants to file and serve the papers on the appeal,

Now, upon reading and filing the affidavit of Mitchell T. Williams, sworn to the 10th day of November, 1965, the no-

tice of said motion, together with proof of due service upon the attorneys for said appellants, the affidavit of Laurence Sovik, sworn to the 23rd day of November, 1965, in opposition thereto, and the reply affidavit of Mitchell T. Williams, sworn to the 29th day of November, 1965, and due deliberation having been had thereon,

It is hereby ORDERED, That said motion be, and the same hereby is granted, and the appeal so taken is hereby dismissed without costs. See Caira v. McKenna, 23 A D 2d 325.

Enter.

LESTER A. FANNING

Entered: 2nd day of December, 1965.

LESTER A. FANNING
Clerk.

ORDER OF JUSTICE RINGROSE GRANTING APPELLEE'S MOTION FOR SUMMARY JUDGMENT IN THE STATE COURT ACTION

PRESENT: HON. E. HOWARD RINGROSE, *Justice.*

The plaintiffs in the above entitled action, having made a motion to strike affirmative defenses of defendant, First Federal Savings and Loan Association of Rochester, pursuant to Rule 3211 of the Civil Practice Law and Rules, to limit questions of fact pursuant to Rule 3212(g) of the Civil Practice Law and Rules, and a motion for summary judgment or, in the alternative, partial summary judgment, pursuant to Rule 3212 of the Civil Practice Law and Rules; the plaintiffs in the above entitled action having also, by order to show cause, having made a motion for an order pursuant to Rule 3025 of the Civil Practice Law and

Rules for permission to file and serve a supplemental complaint; and the plaintiffs in the above entitled action having made a motion to strike the answering affidavit of Mitchell T. Williams, sworn to February 18, 1964, in opposition to plaintiffs' motions to strike affirmative defenses, for summary judgment or partial summary judgment, and to limit questions of fact, and to strike affidavits of Mitchell T. Williams and Cortland L. Brovitz, sworn to February 18, 1964 in support of defendant's motion for summary judgment or, in the alternative, partial summary judgment, and plaintiffs having withdrawn the aforementioned motion by plaintiffs for summary judgment or, in the alternative, partial summary judgment, pursuant to Rule 3212 of the Civil Practice Law and Rules, and plaintiffs having requested that the papers submitted by plaintiffs in support of their motions for summary judgment or, in the alternative, partial summary judgment, be considered by the Court in opposition to the hereinafter mentioned motion by defendant for summary judgment.

Defendant, First Federal Savings and Loan Association of Rochester in the above entitled action having made a motion for an order pursuant to Rule 3212 of the Civil Practice Law and Rules directing that judgment be entered herein in favor of the defendant on the grounds more particularly set forth in defendant's moving papers, the cause of action set forth in the complaint having no merit, and the defendant in the above entitled action having duly moved for an order directing plaintiffs to furnish defendant with a further bill of particulars or to preclude,

NOW, on reading and filing the following:

1. The plaintiffs' complaint herein verified November 21, 1963 and the exhibit thereto, and the answer of defendant,

First Federal Savings and Loan Association of Rochester, verified December 30, 1963, and Schedules A through E, thereto, inclusive;

2. The four (4) third-party summonses and complaints by defendant, First Federal Savings and Loan Association of Rochester, against (a) Myron S. Melvin, Crandall, Melvin, Raymond O. Campbell, Lawson Barnes, Louis Young, Edmund H. Easter, Dominic A. Mazza, George W. Cregg, Charles H. Thompson, Raymond J. Barth, Russell L. Egleston, Edward Brown, Jr., James M. Graham, Eugene F. Bersani, Crandall Melvin, Jr., Joseph S. McMahon, Richard D. Kharas, LaVerne F. O'Dell and Merle D. Melvin, d/b/a Melvin and Melvin of Syracuse, New York; (b) The Bersani Construction Corporation of Syracuse, New York; (c) The Merchants National Bank and Trust Company of Syracuse of Syracuse, New York; and (d) McKay Construction, Inc. of Syracuse, New York, together with Schedules A through D, A through D, A through F, and A through C, inclusive, thereto, respectively;

3. The third-party summons and complaint by third-party defendant, The Merchants National Bank and Trust Company of Syracuse, against third-party defendant, Manufacturers Hanover Trust Company, New York, verified April 21, 1964 and Schedules A through C, thereto, inclusive;

4. The demand for a bill of particulars by defendant, First Federal Savings and Loan Association of Rochester, dated December 30, 1963;

5. The four (4) answers to the third-party complaints brought by defendant, First Federal Savings and Loan Association of Rochester by (a) Myron S. Melvin, Crandall Melvin, Raymond O. Campbell, Lawson Barnes, Louis

Young, Edmund H. Easter, Dominic A. Mazza, George W. Cregg, Charles N. Thompson, Raymond J. Barth, Crandall Melvin, Jr., Joseph S. McMahon, Richard D. Kharas, LaVerne F. O'Dell and Merle D. Melvin, d/b/a Melvin and Melvin, verified February 14, 1964; (b) The Bersani Construction Corporation, verified January 24, 1964; (c) The Merchants National Bank and Trust Company of Syracuse, New York, verified February 14, 1964; and (d) McKay Construction, Inc., verified January 24, 1964;

6. Plaintiffs' bill of particulars verified January 3, 1963 and with Exhibits 1 through 6 thereto, inclusive; plaintiffs' further bill of particulars verified February 22, 1964;

7. Plaintiffs' order to show cause dated February 26, 1964, and the affidavit of Laurence Sovik sworn to February 26, 1964, and unverified supplemental complaint annexed thereto;

8. Plaintiffs' notice of motion, to strike affirmative defenses pursuant to Rule 3211 of the Civil Practice Law and Rules; plaintiffs' notice of motion for summary judgment or, in the alternative, partial summary judgment pursuant to Rule 3212 of the Civil Practice Law and Rules; and plaintiffs' notice of motion to limit questions of fact pursuant to Rule 3212(g) of the Civil Practice Law and Rules dated January 3, 1964, the affidavit of Laurence Sovik sworn to January 3, 1964, and Exhibits 7 through 11, thereto, inclusive;

9. Plaintiffs' notice of motion to strike in part the demand of defendant, First Federal Savings and Loan Association of Rochester, for a bill of particulars pursuant to Section 3042 of the Civil Practice Law and Rules, dated January 2, 1964;

10. Plaintiffs' notice of motion to strike the answering affidavit of Mitchell T. Williams, sworn to February 18,

1964, in opposition to plaintiffs' motion to strike affirmative defenses, for summary judgment or partial summary judgment, and to limit questions of fact and plaintiffs' notice of motion to strike affidavits of Mitchell T. Williams and Cortland L. Brovitz, sworn to February 18, 1964, in support of defendant's motion for summary judgment or, in the alternative, partial summary judgment, dated February 20, 1964.

11. Notice of Motion by defendant, First Federal Savings and Loan Association of Rochester, for summary judgment or, in the alternative, partial summary judgment pursuant to Section 3212 of the Civil Practice Law and Rules dated February 18, 1964, the affidavit of Mitchell T. Williams sworn to February 18, 1964, annexed thereto, and Exhibits A through P, thereto, inclusive;

12. Notice of motion by defendant, First Federal Savings and Loan Association of Rochester, to direct a further bill of particulars or to preclude dated February 18, 1964, and the affidavit of Mitchell T. Williams sworn to February 18, 1964, annexed thereto;

13. The answering affidavit of Mitchell T. Williams sworn to February 18, 1964 for defendant, First Federal Savings and Loan Association of Rochester, in reply to plaintiffs' motion to strike affirmative defenses, summary judgment or partial summary judgment, and to limit questions of fact, pursuant to Section 3112 of the Civil Practice Law and Rules;

14. The supplemental affidavit, for defendant First Federal Savings and Loan Association of Rochester, of Cortland L. Brovitz sworn to March 19, 1964;

15. The affidavit, for defendant First Federal Savings and Loan Association of Rochester, of Herbert A. Ross sworn to March 19, 1964;

16. The affidavit, for defendant First Federal Savings and Loan Association of Rochester, of Eugene F. Bersani sworn to March 16, 1964;

17. The affidavit, for defendant First Federal Savings and Loan Association of Rochester, of Mitchell T. Williams sworn to March 19, 1964, Exhibits Q through U-2, inclusive, annexed thereto;

18. Reply affidavit, for plaintiffs, of Robert N. Smith sworn to February 27, 1964;

19. Affidavit, for plaintiffs, in opposition to defendant's motion for summary judgment by Laurence Sovik sworn to May 12, 1964.

Plaintiffs' motion for summary judgment having been withdrawn, those papers hereinabove mentioned submitted by the plaintiffs herein having been considered by the Court as requested by plaintiffs, in opposition to the defendant's motion for summary judgment, and after hearing Robinson, Williams, Brown, Robinson, and Angeloff, attorneys for the defendant, First Federal Savings and Loan Association of Rochester, Mitchell T. Williams, Esq. of counsel, in support of the motion by defendant, First Federal Savings and Loan Association of Rochester, for summary judgment and Smith, Sovik, Terry, Kendrick, McAuliffe and Schwarzer for the plaintiffs, Laurence Sovik, Esq., in opposition thereto, and due deliberation having been had, it is upon motion of Robinson, Williams, Brown, Robinson and Angeloff, attorneys for the defendant, First Federal Savings and Loan Association of Rochester, Mitchell T. Williams, Esq. of counsel, for the aforesaid defendant,

ORDERED, that said motion for summary judgment by the defendant, First Federal Savings and Loan Association

of Rochester be and it hereby is in all respects granted, and it is

FURTHER ORDERED, that the complaint be and the same hereby is dismissed and summary judgment granted defendant, First Federal Savings and Loan Association of Rochester, with $25.00 cost of this motion, and it is

FURTHER ORDERED, that the aforesaid motions by the plaintiffs to strike in part the demand of the defendant for a bill of particulars pursuant to Section 3042 of the Civil Practice Law and Rules, to strike affirmative defenses pursuant to Section 3211 of the Civil Practice Law and Rules, to limit questions of fact pursuant to Section 3212(g), to strike answering affidavits of Mitchell T. Williams in opposition to plaintiffs' motion to strike affirmative defenses, to strike the affidavit of Mitchell T. Williams and Cortland L. Brovitz in support of defendant's motion pursuant to Section 3212 of the Civil Practice Law and Rules for summary judgment or partial summary judgment, and to permit plaintiffs to file and serve a supplemental complaint, be and they hereby are in all respects denied, without costs, and since the granting herein of summary judgment to defendant, First Federal Savings and Loan Association of Rochester, renders a further bill of particulars or preclusion unnecessary, the motion by defendant for an order directing plaintiffs to furnish defendant with a further bill of particulars or to preclude be and is also hereby denied without costs, and it is

FURTHER ORDERED, that judgment be entered herein by the Clerk of this Court in favor of the defendant, First Federal Savings and Loan Association of Rochester, and against the plaintiffs, Phillip J. McNellis, as Trustee of Donald S. Potter, Bankrupt, and Potter Securities Corpora-

tion, Bankrupt, and Eugene H. Klein, as Trustee of Randoph House Motor Hotel Corp., Bankrupt, for the costs and disbursements of this action to be taxed by the Clerk of the Court and $25.00, cost of this motion.

Signed this 9th day of July, 1964, at Rome, New York.

Enter:

/s/ E. H. RINGROSE
E. HOWARD RINGROSE
Justice, Supreme Court
Onondaga County

Clerk

Filed and Entered
July 14, 1964

OPINION OF FEINBERG, J. FOR THE UNITED STATES COURT OF APPEALS.

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 357—September Term, 1965.

(Argued May 2, 1966 Decided July 27, 1966.)

Docket No. 30327

PHILLIP J. MCNELLIS as Trustee of DONALD S. POTTER, Bankrupt *et al.*,

Plaintiffs-Appellants,

—against—

FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF ROCHESTER, 320 E. Main Street, Rochester, New York,

Defendant-Appellee.

Before:

LUMBARD, *Chief Judge,*
MOORE and FEINBERG, *Circuit Judges.*

Appeal from an order of the United States District Court for the Northern District of New York, Brennan, *J.*, granting a motion for summary judgment dismissing the complaint on the ground of *res judicata*. Reversed.

LAURENCE SOVIK, Syracuse, New York (Smith, Sovik, Terry, Kendrick, McAuliffe & Schwarzer, on the brief), *for Plaintiffs-Appellants.*

CARL ANGELOFF, Rochester, New York (Robinson, Williams, Brown, Robinson and Angeloff; Frank Aloi, on the brief), *for Defendant-Appellee.*

FEINBERG, *Circuit Judge*:

Appellants, two trustees in bankruptcy, appeal from an order of the District Court for the Northern District of New York, which granted appellee's motion for summary judgment and dismissed the complaint. In a memorandum opinion, Judge Brennan held that the principles of *res judicata* compelled this result. For reasons set forth below, we reverse.

In November 1963, appellants sued defendant-appellee First Federal Savings and Loan Association of Rochester ("First Federal") in the New York Supreme Court, Onondaga County, in a two-count complaint. The first count alleged that plaintiffs were the trustees in bankruptcy of Randolph House Motor Hotel Corp. ("Randolph"), Donald S. Potter, Jackson M. Potter, and Potter Securities Corporation ("Potter Corp."), all adjudicated bankrupt in June 1963; that at all relevant times Donald Potter was insolvent and owned all the stock of Randolph, which was also insolvent; that Potter Corp. was a "dummy" organized by the Potters to hold title to certain properties for Donald Potter in order to conceal usurious transactions; that title to certain premises passed without consideration back and forth from Donald Potter to Potter Corp. several times and finally from that corporation to Randolph; that Donald Potter paid for the construction of a motor hotel on the premises; that a substantial portion of the materials and services for the construction was furnished by unsecured creditors of Donald Potter and Randolph; that on or about

April 27, 1962, First Federal entered into a mortgage commitment agreement with Potter Corp. on behalf of Donald Potter, under which Donald Potter paid First Federal $62,000 on April 27, 1962 and again on June 21, 1962; and that each payment, although characterized as a "mortgage origination fee," was actually intended to be interest on mortgage indebtedness in excess of that authorized by the New York General Business Law and federal statutes relating to banks and banking. The second count of the complaint alleged that the two payments of $62,000 were fraudulent dispositions of the bankrupts' property; that the payments were made without fair consideration and in violation of the New York Debtor and Creditor Law; and that they were made when defendant knew or should have known the bankrupts were insolvent and unable to pay their liabilities as they would mature. The complaint sought judgment for $248,000, with interest.[1]

Both sides moved for summary judgment in the state court action; plaintiffs' motion was later withdrawn. While the motions were pending, plaintiffs moved for permission to file and serve a supplemental complaint as "a third separate and distinct cause of action." After incorporating the original complaint, the supplemental complaint alleged that Donald Potter paid a total of $55,144 to First Federal on the mortgage ($3,100 on August 2, 1962, $26,022 on September 6, 1962, and $26,022 on September 21, 1962); that these payments were in violation of New York Debt. & Cred. Law §§273-76, New York Banking Law §380-e, and section 67d (2) of the Bankruptcy Act; and that defendant knew at the time of the payments that the bankrupts were insolvent

1 Plaintiffs sought double damages apparently under New York Banking Law §380-e.

and unable to pay their liabilities. The additional relief prayed for was a judgment of $110,288[2] and attorneys' fees.

In May 1964, while these motions were pending in the state court, appellants commenced the action in the court below. The federal complaint alleged virtually everything in the state complaints and a few more details of the transactions in question were provided. The complaint alleged that the two $62,000 payments represented illegal interest in violation of New York Banking Law §380-e and Article 10 of the New York Debtor and Creditor Law, and that the second $62,000 payment and the three subsequent payments totalling $55,144 were in violation of section 67d of the Bankruptcy Act and Article 10 of the New York Debtor and Creditor Law. The complaint sought double damages ($248,000) on the claims arising out of the two $62,000 payments and single damages ($55,144) on the later three payments.

First Federal moved below for summary judgment or a stay of proceedings on the ground that a state court action for the same relief was pending; Judge Brennan granted a stay pending determination of the state action. In June 1964, First Federal's motion for summary judgment in the New York Supreme Court was granted by Justice Ringrose. The judge viewed the state court action as one to recover $248,000 for violation of the usury statutes, requiring a piercing of the corporate veil to overcome the exception for corporate borrowers. He held that there had to be proof that there was a loan in fact to an individual (Donald Potter), which the parties might wish to conceal, but that the loan had actually been made to Randolph, which also paid the "mortgage origination fee" of $124,000. He stated that the documentary proof established that no payments

---

2 See note 1, *supra*.

had been made by Donald Potter to defendant First Federal. For a number of reasons which need not concern us here, the state court refused to pierce the corporate veil to hold usurious the two payments of $62,000. The opinion focussed on those two payments, which, as indicated above, were the subject of the two counts of the original state court complaint; the opinion did not mention the three later payments, totalling $55,144, which were the subject of the proposed supplemental state court complaint. At the end of the opinion, Justice Ringrose alluded to six pending motions in the case and denied them all without discussion. He stated, *inter alia,*

> In view of the decision above announced, the following motions concurrently or subsequently argued or submitted by the plaintiffs in this action are denied without costs:
>
> * * * * *
>
> SIXTH: Permitting plaintiffs to file and serve a supplemental complaint.

An appeal was taken from this decision but was later dismissed in December 1965.[3]

At this point, First Federal understandably renewed its motion in the court below for summary judgment. Apparently, plaintiffs did not dispute below that the state court decision barred their federal action insofar as it sought relief because of a usurious "origination fee." Plaintiffs did insist, however, that the claim for $55,144 based on

---

3 First Federal's motion to dismiss the appeal for failure of appellants to file and serve the papers on appeal was granted by the Appellate Division of the Supreme Court, Fourth Department on December 2, 1965.

the three subsequent payments on the mortgage in August and September 1962 was not barred. Judge Brennan held that since the state court determined that usury rules were inapplicable, the August and September payments made on a valid mortgage could hardly be invalidated. Judge Brennan also relied on the state court denial of permission to file the supplemental complaint, and the identity between the proposed third cause of action contained therein and the relevant portion of the instant complaint. He concluded that "the principle of res judicata" required granting defendant's motion for summary judgment.

Appellants' only contention here is that the court misapplied the principles of *res judicata*.[4] What those principles are in general is not difficult to state; applying them to specific situations is sometimes another matter. Briefly, where a judgment has been rendered in an action between two parties for a sum of money and there is subsequently another action between the same parties, the first judgment has varying conclusive effect. If the second action is based upon the same cause of action as the first, the prior judgment is conclusive as to all matters which were litigated or might have been litigated in the first action. However, if the second action is based upon a different cause of action, the prior judgment is conclusive between the parties only as to matters actually litigated and determined by the first judgment; that judgment is not conclusive as to matters which might have been, but which were not, litigated and

---

4 Appellee claims that this court must look to state law to determine the effect of the prior judgment; appellants do not address themselves to this point. *Cf.* Comment, *Res Judicata in the Federal Courts: Application of Federal or State Law: Possible Differences Between the Two*, 51 Cornell L. Q. 96 (1965). In any event, we do not feel that the state and federal law differ sufficiently in the area crucial in this case to require further exploration here of the choice of law problem.

determined in the prior action. *Cromwell* v. *County of Sac*, 94 U. S. 351, 352-53 (1877); Restatement, Judgments, 158-59 (1942). The obvious beginning for an inquiry into *res judicata* is a determination of what was claimed and decided in the first action. The state court complaint alleged that payments of $62,000, in April and June 1962, represented usurious interest (count one) and were a fraud on creditors (count two). The state court held that a corporate-borrower could not avail itself of usury rules. The only reference to the fraudulent transfer aspects of the complaint was that Randolph was solvent on June 21, 1962 (the date of the second $62,000 payment and of transfer of title to Randolph from Potter Corp.).[5] The court also denied without discussion permission to file a supplemental complaint substantially identical to the portion involved here of the complaint below.

Putting the supplemental complaint to one side for the moment, we cannot see how the dismissal of counts one and two of the state court complaint, based on payments in April and June 1962, bars the action here to recover other types of payments in August and September. Although analysis is rendered somewhat difficult by the jumble of theories and allegations in the complaints and briefs, it is quite clear that the federal complaint is now reduced only to recovery of a fraudulent transfer. In fact, plaintiffs use to their advantage the state court determination that Donald Potter was not the "real borrower." They assert that if this is so, then payments by Potter of $55,144 on a mortgage incurred by someone else (Randolph) were without consideration; since the payments were made within one

---

5 The court also noted that apparently at the same date a contract to sell the property for $5,250,000 was in existence and the encumbering mortgages did not exceed $5,057,142.50.

year prior to bankruptcy at a time when he was insolvent, they were fraudulent transfers. The claim that appellants now press has nothing to do with usury or the "origination fee" and the fact that the later three payments may have represented interest is irrelevant. Therefore, the action now presented in its truncated form in the federal court is clearly a different cause of action from the action presented in count one of the original state complaint. It is true that count two of that complaint did contain a theory of fraudulent transfer to justify recovery of the $62,000 payments. But this theory depended upon establishing insolvency on April 27 or on June 21, 1962—the dates of the two payments—and concerned only these two payments. A cause of action for a fraudulent transfer in June is not the same as a cause of action for a fraudulent transfer in August or September. Restatement, Judgments §61, comment *c* (1942). Appellee emphasizes that all payments grew out of the same mortgage and that the mortgage, as pointed out by the court below, has been held valid. However, appellants are not now relitigating the legality of the mortgage; they assume it is valid, but question the propriety of payments on it by an alleged stranger to the transaction, Donald Potter. We conclude that the cause of action now pressed is not the same as that originally presented to the state court.

We do not view any of the cases cited by appellee on determining what is the same "cause of action" as compelling a contrary result. *Cf.* Developments in the Law—Res Judicata, 65 Harv. L. Rev. 818, 824-25 (1952). *Williamson* v. *Columbia Gas & Elec. Corp.*, 186 F. 2d 464 (3d Cir. 1950), cert. denied, 341 U. S. 921 (1951), involved two civil antitrust suits, one based upon the Sherman Act, the other on the Clayton Act. The court concluded that the same

operative facts were present in each and that different theories of recovery did not necessarily mean different causes of action, a proposition we do not dispute. Of course, the issue then is what are the "operative facts"; here, unlike *Williamson*, significantly different evidence is required, see Restatement, Judgments §61 (1942), different time periods are involved and different amounts are sought. *Kaufman* v. *Shoenberg*, 154 F. Supp. 64 (D. Del. 1954), is similarly distinguishable. *Smith* v. *Kirkpatrick*, 305 N. Y. 66 (1953), and *Schuylkill Fuel Corp.* v. *B. & C. Nieberg Realty Corp.*, 250 N. Y. 304 (1929), if anything, support the conclusion we reach here. In the latter case, the court said at 250 N. Y. 308: "The decisive test is this, whether the substance of the rights or interests established in the first action will be destroyed or impaired by the prosecution of the second." As indicated above, the state action here determined that the two $62,000 payments could not be recovered by the trustees; success in the action now before us could not "destroy or impair" that determination. Appellee's other cases similarly do not require us to hold that *res judicata* bars the trustees.

The present action might still be barred, however, if it could be fairly said that the issues still present had been litigated and decided in the state court action, but such is not the case. Appellants did claim in the state court that Donald Potter made the two $62,000 payments, and the state court held he did not. But that court did not have before it in the original state complaint the question whether Potter individually made the August and September payments. While Justice Ringrose stated that "no payments were made at any time by Donald S. Potter to the defendant," it is obvious that he was focussing only on payments up to June 21, 1962.

Therefore, since the cause of action still pressed by the trustees in this court is a different one from the cause of action originally presented to the state court in counts one and two of the state court complaint and since the key issues now presented were not there litigated and decided, normally principles of *res judicata* would not bar the action. However, there must still be considered the effect of the ambiguous disposition in the state court of the proposed supplemental complaint; *i.e.*, was there a judgment on the merits of that complaint sufficient to justify application of *res judicata* rules. If that proposed third cause of action had been included in the original state court complaint and defendant's motion for summary judgment had also been addressed to it, it may be conceded that plaintiffs would now be barred; identity both of parties and cause of action would present a classic case for applying the salutary policies behind the *res judicata* doctrine. However, the count was not included in the original complaint; according to the trustees, the reason it was not was that they did not find out about the August and September payments until after the state complaint had been filed.[6] Therefore, count three was never filed and technically was not before the state court; moreover, granting that this formality should not control, it is also quite clear that count three was never before the court in a realistic sense either. Plaintiffs' motion to file a supplemental pleading was brought under N. Y. Civ. Prac. R. 3025(b), which provides that "leave shall be freely given." Despite this statement of a liberal policy, the cursory reason given for denial of leave was "in

---

6 Phillip J. McNellis was appointed bankruptcy trustee of the estates of Donald S. Potter and Potter Corp. on June 25, 1963. The state court suit was brought on November 21, 1963; the motion to file a supplemental complaint was brought on February 26, 1964.

view of the decision above announced." That decision did not discuss the fraudulent conveyance theory of the first complaint and focussed almost entirely on the usury aspects of that complaint; moreover, it dealt only with the issues arising out of the two payments of $62,000. We also note that N. Y. Civ. Prac. R. 5013 provides:

> A judgment dismissing a cause of action before the close of the proponent's evidence is not a dismissal on the merits unless it specifies otherwise, but a judgment dismissing a cause of action after the close of the proponent's evidence is a dismissal on the merits unless it specifies otherwise.

Since no motion for summary judgment with respect to the cause of action pleaded in the supplemental complaint was ever brought, there was no evidence at all adduced in plaintiffs' favor. And, as the proposed third cause of action was not even "dismissed," this would seem to be an *a fortiori* case for concluding that disposal of the supplemental complaint was not, on the merits. Finally, although the principles of *res judicata* should not be frugally applied, cf. *United States* v. *Munsingwear, Inc.*, 340 U. S. 36, 38 (1950), a reasonable doubt as to what was decided in the first action should preclude the drastic remedy of foreclosing a party from litigating an essential issue.[7] *Cf.* Cleary, *Res Judicata Reexamined*, 57 Yale L. J. 339 (1948). Under these circumstances, while it is conceivable that in denying leave to file the supplemental complaint, Justice Ringrose decided on the merits that the three payments in

---

7 This would dispose of appellee's contention that *Angel* v. *Bullington*, 330 U. S. 183 (1947), controls here; the case is also inapposite because we do not have here, in any event, the closing of the door by the state to an entire class of suits.

August and September 1962 were not fraudulent transfers, the proposition is not persuasive.[8]

In summary, we conclude that there is no *res judicata* bar to the trustees' action on grounds other than usury based on the three payments which totalled $55,144.

Judgment reversed.

---

8 The burden of showing the meaning of the former adjudication is on the party asserting the bar of *res judicata*. *Hyslop* v. *United States*, 261 F. 2d 786 (8th Cir. 1958); *Peckham* v. *Family Loan Co.*, 196 F. 2d 838 (5th Cir. 1952); *J. B. Sparrow Theatrical Amusement Co.* v. *Mack*, 195 Fed. 474 (2d Cir. 1912).